



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-138526-14]

RIN 1545-BM46

Issue Price Definition for Tax-Exempt Bonds

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Partial withdrawal of notice of proposed rulemaking, notice of proposed rulemaking, and notice of public hearing.

**SUMMARY:** This document partially withdraws the portion of the notice of proposed rulemaking published in the **Federal Register** on September 16, 2013 (78 FR 56842), relating to the definition of issue price for purposes of the arbitrage restrictions under section 148 of the Internal Revenue Code (Code). This document also contains a notice of proposed rulemaking that provides a revised definition of issue price for purposes of the arbitrage restrictions. In addition, this document provides notice of a public hearing on the proposed regulations in this document. The proposed regulations in this document affect issuers of tax-exempt and other tax-advantaged bonds.

**DATES:** Written or electronic comments must be received by **[INSERT 90 DAYS**

**AFTER PUBLICATION IN THE FEDERAL REGISTER]**. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for **October 28, 2015**,

at 10:00 a.m., must be received by **[INSERT 90 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-138526-14), Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand delivered to: CC:PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-138526-14), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG-138526-14). The public hearing will be held at the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Lewis Bell at (202) 317-6980; concerning submissions of comments and the hearing, Oluwafunmilayo (Funmi) Taylor at (202) 317-6901 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Paperwork Reduction Act**

The collection of information contained in § 1.148-1 has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1347. The collection of information in this proposed regulation is in §1.148-1(f)(2)(ii) which contains a requirement that the issuer obtain certifications and supporting documentation regarding the underwriter's sales of the issuer's bonds. The collection of information in §1.148-1(f)(2)(ii) is an increase in the total annual burden under control number 1545-

1347. The respondents are issuers of tax-exempt bonds that wish to use the alternative method in §1.148-1(f)(2)(ii).

Estimated total annual recordkeeping burden: 52,276 hours.

Estimated average annual burden hours per respondent: 4 hours.

Estimated number of respondents: 12,546.

Estimated annual frequency of responses: 20,910.

Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:CAR:MP:T:T:SP, Washington DC 20224. Comments on the collection of information should be received by **[INSERT 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

Comments are sought on whether the proposed collection of information is necessary for the proper performance of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques and other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by section 6103.

## **Background**

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) on the arbitrage investment restrictions under section 148 of the Code. On June 18, 1993, the Department of the Treasury (Treasury Department) and the IRS published comprehensive final regulations in the **Federal Register** (TD 8476, 58 FR 33510) on the arbitrage investment restrictions and related provisions for tax-exempt bonds under sections 103, 148, 149, and 150. Since that time, those final regulations have been amended in certain limited respects (the regulations issued in 1993 and the amendments thereto are collectively referred to as the Existing Regulations).

A notice of proposed rulemaking was published in the **Federal Register** (78 FR 56842; REG-148659-07) on September 16, 2013 (the 2013 Proposed Regulations), which proposes amendments to the Existing Regulations to address market developments, simplify certain provisions, address certain technical issues, and make the regulations more administrable. One significant change in the 2013 Proposed

Regulations addresses the definition of issue price. Comments were received, and a public hearing was held on February 5, 2014. After considering the comments and the statements made at the public hearing, the Treasury Department and the IRS have decided to withdraw §1.148-1(f) of the 2013 Proposed Regulations relating to issue price and to propose new regulations. This document (the Proposed Regulations) contains the re-proposed definition of issue price. The Treasury Department and the IRS will address the remaining provisions contained in the 2013 Proposed Regulations at a later time.

### **Explanation of Provisions**

For purposes of the arbitrage investment restrictions, section 148(h) provides that yield on an issue is to be determined on the basis of the issue price (within the meaning of sections 1273 and 1274). The reason for using issue price (rather than sales proceeds less the costs of issuance) to determine yield for purposes of section 148(h) is to ensure that issuers bear the costs of issuance, rather than recover these costs through arbitrage profits. See H. Rep. No. 99-426, at 517 (1985). Congress thought that this requirement would encourage issuers to scrutinize costs of issuance more closely and would encourage better targeting of the federal subsidy associated with tax-exempt bonds. *Id.*, at 517-518. The issue price definition under the Existing Regulations generally follows the issue price definition used for computing original issue discount on debt instruments under sections 1273 and 1274, with certain modifications. The definition under the Existing Regulations provides that generally the issue price of bonds that are publicly offered is the first price at which a substantial amount of the bonds is sold to the public. However, the issue price definition in the Existing

Regulations defines substantial amount as ten percent and applies a reasonable expectations standard (rather than a standard based on actual sales) for determining the issue price of bonds that are publicly offered. Specifically, the issue price of bonds for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial offering price. The issue prices of bonds with different payment and credit terms are determined separately. Notice 2010-35, published May 10, 2010 (2010-19 IRB 660), provides that the arbitrage definition of issue price also applies to other tax-advantaged bond programs, including Build America Bonds under section 54AA and other Qualified Tax Credit Bonds under section 54A.

The definition of issue price in the 2013 Proposed Regulations differs significantly from that in the Existing Regulations. Consistent with section 148(h), the 2013 Proposed Regulations retain the rule that issue price generally will be determined under the rules of sections 1273 and 1274. The 2013 Proposed Regulations parallel the language in the existing section 1273 regulations by providing that the issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public. The 2013 Proposed Regulations provide a safe harbor under which an issuer may treat the first price at which a minimum of 25 percent of the bonds in an issue (with the same credit and payment terms) actually is sold to the public as the issue price, provided that all orders at this price received from the public during the offering period are filled (to the extent that the public orders at such price do not exceed the amount of bonds sold). Thus, the 2013 Proposed Regulations base the determination of issue price on actual sales prices instead of reasonably expected sales

at initial public offering prices. The 2013 Proposed Regulations also remove the definition of a “substantial amount” as ten percent.

The 2013 Proposed Regulations define the term “public” to mean any person other than an “underwriter.” The 2013 Proposed Regulations define the term “underwriter” to mean any person that purchases bonds from the issuer for the purpose of effecting the original distribution of the bonds or otherwise participates directly or indirectly in the original distribution. An underwriter includes a lead underwriter and any member of a syndicate that contractually agrees to participate in the underwriting of the bonds for the issuer. A securities dealer (whether or not a member of the issuer’s underwriting syndicate) that purchases bonds (whether or not from the issuer) for the purpose of effecting the original distribution of the bonds is also treated as an underwriter for this purpose. An underwriter generally includes a party related to an underwriter. A person that holds bonds for investment is not an underwriter with respect to those bonds.

A number of comments were received on the 2013 Proposed Regulations issue price definition. In general, the commenters requested the withdrawal of the portion of the 2013 Proposed Regulations relating to the definition or the re-proposal of the definition using the existing reasonable expectations test regarding the initial public offering price, with certain clarifications. Commenters pointed out that issue price must be determined as of the sale date to provide certainty that the bonds will qualify as tax-exempt and meet state or local requirements for debt issuance. The sale date is the date when the syndicate or sole underwriter in contractual privity with the issuer signs the agreement to buy the bonds from the issuer and when the terms of the bond issue

are set. Commenters expressed concern about insufficient sales of bonds preventing a timely determination of issue price on the sale date. The commenters noted that the syndicate or sole underwriter in contractual privity purchases the bonds from the issuer, so the syndicate or sole underwriter, rather than the issuer, will bear the risk of any market fluctuations after the sale date. Because the issuer neither bears this risk nor receives any further proceeds, any later change in price is not a factor that affects the costs of issuance paid by the issuer. In addition, later sales prices could reflect changes in the market, whereas the purpose of using issue price is to preclude recovery of issuance costs through arbitrage profits. See H. Rep. No. 99-426, at 517.

In general, the lower the issue price for the bonds bearing a stated interest rate, the higher the yield. Economically, the issuer should want to receive the highest price for the bonds and pay the lowest yield. This aligns with the purpose of the arbitrage provisions to minimize arbitrage investment benefits and remove incentives to issue more tax-exempt bonds, and thus to limit the federal revenue cost of the tax subsidy for tax-exempt bonds. Many of the commenters stated, however, that the use of actual sales prices likely would result in lower bond offering prices so as to ensure that each issue would meet the 25 percent threshold in the safe harbor in the 2013 Proposed Regulations as of the sale date of the bonds. The commenters pointed to unsold bonds in particular maturities of an overall tax-exempt bond issue that includes a series of bonds with separate maturities and issue prices as the particular impediment to meeting an actual sale requirement as of the sale date. These lower bond prices would reduce proceeds and increase borrowing costs for issuers, increase bond yields for arbitrage purposes, and increase federal tax subsidies.



In addition, commenters suggested that the definition of underwriter in the 2013 Proposed Regulations was unduly broad and ambiguous. In particular, commenters expressed concern that the 2013 Proposed Regulations effectively required the issuer to obtain price information from dealers that are not in a contractual relationship with the issuer or underwriting syndicate. The commenters also expressed concern that the proposed definition of underwriter necessitated determining a dealer's intent for buying bonds because whether a dealer was an underwriter depended upon whether the dealer purchased bonds with "the purpose of effecting the original distribution of the bonds."

In response to the comments received, the Treasury Department and the IRS are re-proposing an amended definition of issue price for tax-exempt bonds. Consistent with section 148(h), the Proposed Regulations retain the rule that issue price generally will be determined under the rules of sections 1273 and 1274. The Proposed Regulations also parallel the language in the existing section 1273 regulations and the Existing Regulations by providing that the issue price of bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public. This rule uses actual sales to determine issue price and is consistent with section 1273. The Proposed Regulations retain the rule in the Existing Regulations that ten percent is a substantial amount.

The Proposed Regulations also retain the rule for tax-exempt bonds that the issue prices of bonds with different payment and credit terms are determined separately. Tax-exempt bond issues often include bonds with different payment and credit terms that generally sell at different prices. In response to commenters' concerns

regarding the need for certainty with respect to the determination of issue price of the issue as of the sale date and that less than a substantial amount of particular bonds included within an issue may be sold by that time, the Proposed Regulations provide an alternative method of determining issue price for bonds a substantial amount of which is not sold pursuant to orders received from the public as of the sale date. Under this alternative method, an issuer may treat the initial offering price to the public as the issue price, provided certain requirements are met.

In particular, the alternative method requires that the underwriters fill all orders at the initial offering price placed by the public and received by the underwriters on or before the sale date (to the extent the orders do not exceed the amount of bonds to be sold) and do not fill any order received by the underwriters on or before the sale date at a price higher than the initial offering price. Further, the alternative method requires the lead underwriter (or sole underwriter, if applicable) to provide certification with respect to certain matters under the alternative method, including a certification that no underwriter will fill an order received from the public after the sale date and before the issue date at a price higher than the initial offering price, except if the higher price is the result of a market change for those bonds after the sale date (for example, due to a change in interest rates), and that it will provide the issuer with supporting documentation for the matters covered by the certifications.

Documentation of the initial offering price may include a copy of the pricing wire (or equivalent communication). Documentation of bonds for which an underwriter filled an order placed by the public after the sale date and before the issue date at a price higher than the initial offering price includes both pricing information (amounts, prices,

and sale dates) and information regarding the corresponding market change, such as proof of the values of a broad-based index of municipal bond interest rates on bonds similar to the type and credit rating of the bonds being sold. The issuer must not know or have reason to know, after exercising due diligence, that the certifications are false.

The Treasury Department and the IRS recognize that, under syndicate agreements among underwriters and MSRB rules, underwriters are free to sell bonds after the bond purchase agreement is signed at a fair and reasonable price different from the initial offering price. The alternative method allows the use of initial offering price as the issue price in circumstances in which bonds are sold after the sale date and before the issue date at a higher price, provided that the higher price results from a market change for those bonds after the sale date. Based on available data, the Treasury Department and the IRS believe that the frequency of sales by underwriters at higher prices between the sale date and the issue date is limited. Thus, the burden, in effect, of requiring underwriters to maintain initial public offering prices for unsold bonds until the issue date absent justification for higher prices based on market changes should be limited. The Treasury Department and the IRS request comments on other safeguards or alternative approaches to ensure that the prices obtained by underwriters in actual sales of bonds to the public between the sale date and the issue date are consistent with use of initial offering prices to the public as of the sale date as a simplifying assumption for issue price determinations in the alternative method.

The Proposed Regulations define “public” for purposes of determining the issue price of tax-exempt bonds as any person other than an underwriter or a related party to an underwriter. The Proposed Regulations define “underwriter” to include (i) any person

that contractually agrees to participate in the initial sale of the bonds to the public by entering into a contract with the issuer or into a contract with a lead underwriter to form an underwriting syndicate and (ii) any person that, on or before the sale date, directly or indirectly enters into a contract or other arrangement to sell the bonds with any of the foregoing (for example, a retail distribution contract between a member of an underwriting syndicate or selling group and another dealer that is not in the syndicate or selling group).

The Proposed Regulations remove as unnecessary a rule in the Existing Regulations expressly stating that the issue price does not change if part of the issue is later sold at a different price. The Treasury Department and the IRS intend no substantive change by the removal.

In accordance with section 6001, the issuer should maintain documentation in its books and records to support its issue price determinations. This documentation includes the specific certifications and documentation required to determine issue price under the alternative method, as well as documentation to support issue price determinations under the general rule. For example, under the general rule, an issuer should include in its books and records any certification from the lead (or sole) underwriter regarding the first price at which a substantial amount of the bonds were sold to the public and reasonable supporting documentation for this price.

#### **Proposed Effective/Applicability Date**

The Proposed Regulations are proposed to apply prospectively to bonds that are sold on or after the date that is 90 days after publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. In addition, issuers

may rely upon the Proposed Regulations with respect to bonds that are sold on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, and before the date that is 90 days after publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) does not apply.

It is hereby certified that these Proposed Regulations, if adopted, would not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. This certification is based generally on the fact that any effect on small entities by these rules generally flows from section 148 of the Code.

Section 148(h) of the Code requires the yield on an issue of bonds to be determined on the basis of issue price (within the meaning of sections 1273 and 1274). Under section 1273, the issue price is the first price at which a substantial amount of the bonds were sold to the public. Section 1.148-1(f)(2)(ii) of the Proposed Regulations gives effect to the statute by requiring the issuer to obtain certifications and documentation regarding sales of the bonds from the underwriter of the bonds, which is the party that sells the bonds to the public. This information will be used to support the issue price of the bonds for audit and other purposes. Any economic impact of

obtaining this information is minimal because most of the information already is provided to issuers by the underwriters under existing industry practices. Accordingly, these proposed changes do not add to the impact on small entities imposed by the statutory provision. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Public Hearing**

Before these Proposed Regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “Addresses” heading. The IRS and the Treasury Department request comments on all aspects of the proposed rules. All comments that are submitted by the public will be available for public inspection and copying at [www.regulations.gov](http://www.regulations.gov) or upon request.

A public hearing has been scheduled for October 28, 2015, at 10:00 a.m., in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For more information about having your name placed on the building access list to attend the hearing, see the “FOR FURTHER INFORMATION CONTACT” section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and

an outline of the topics to be discussed and the time to be devoted to each topic by **[INSERT 90 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**. Such persons should submit a signed paper original and eight (8) copies or an electronic copy. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### **Drafting Information**

The principal authors of these regulations are Johanna Som de Cerff and Lewis Bell, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **Partial Withdrawal of Notice of Proposed Rulemaking**

Accordingly, under the authority of 26 U.S.C. 7805, §1.148-1(f) of the notice of proposed rulemaking (REG-148659-07) that was published in the **Federal Register** on September 16, 2013 (78 FR 56842), is withdrawn.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### **PART 1--INCOME TAXES**

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.148-0(c) is amended by adding entries for §§1.148-1(f) and 1.148-11(m) to read as follows:

§1.148-0 Scope and table of contents.

\* \* \* \* \*

(c) Table of contents. \* \* \*

§1.148-1 Definitions and elections.

\* \* \* \* \*

(f) Definition of issue price.

(1) In general.

(2) Bonds issued for money.

(3) Definitions.

(4) Special rules.

\* \* \* \* \*

§1.148-11 Effective/applicability dates.

\* \* \* \* \*

(m) Definition of issue price.

Par. 3. Section 1.148-1 is amended by revising the definition of issue price in paragraph (b) and adding paragraph (f) to read as follows:

§1.148-1 Definitions and elections.

\* \* \* \* \*

(b) \* \* \*

Issue price means issue price as defined in paragraph (f) of this section.

\* \* \* \* \*

(f) Definition of issue price--(1) In general. Except as otherwise provided in this paragraph (f), issue price is defined in sections 1273 and 1274 and the regulations under those sections.



(2) Bonds issued for money--(i) In general. The issue price of bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public.

(ii) Alternative method based on initial offering price. As an alternative to the general rule in paragraph (f)(2)(i) of this section, if the underwriters have not received orders placed by the public for a substantial amount of tax-exempt bonds on or before the sale date, the issuer may treat the initial offering price to the public as the issue price of the bonds if all of the following requirements are met:

(A) The underwriters fill all orders at the initial offering price placed by the public and received by the underwriters on or before the sale date (to the extent the orders do not exceed the amount of bonds to be sold), and no underwriter fills an order placed by the public and received by the underwriters on or before the sale date at a price higher than the initial offering price.

(B) The issuer obtains from the lead underwriter in the underwriting syndicate or selling group (or, if applicable, the sole underwriter) certification of the following:

(1) The initial offering price;

(2) That the underwriters met the requirements of paragraph (f)(2)(ii)(A) of this section;

(3) That no underwriter will fill an order placed by the public and received after the sale date and before the issue date at a price higher than the initial offering price, except if the higher price is the result of a market change (such as a decline in interest rates) for those bonds after the sale date; and

(4) That the lead (or sole) underwriter will provide the issuer supporting documentation for the matters covered by the certifications in paragraphs (f)(2)(ii)(B)(1)

and (2) of this section and, with regard to paragraph (f)(2)(ii)(B)(3) of this section, either documentation regarding any bonds for which an underwriter filled an order placed by the public and received after the sale date and before the issue date at a price higher than the initial offering price and the corresponding market change for those bonds, or a certification that no underwriter filled such orders at a price higher than the initial offering price.

(C) The issuer does not know or have reason to know, after exercising due diligence, that the certifications described in paragraph (f)(2)(ii)(B) of this section are false.

(3) Definitions. For purposes of this paragraph (f), the following definitions apply:

(i) Public. Public means any person (as defined in section 7701(a)(1)) other than an underwriter or a related party (as defined in §1.150-1(b)) to an underwriter.

(ii) Underwriter. The term underwriter include--

(A) Any person (as defined in section 7701(a)(1)) that contractually agrees to participate in the initial sale of the bonds to the public by entering into a contract with the issuer (or with the lead underwriter to form an underwriting syndicate); and

(B) Any person that, on or before the sale date, directly or indirectly enters into a contract or other arrangement with a person described in paragraph (f)(3)(ii)(A) of this section to sell the bonds.

(4) Special rules. For purposes of this paragraph (f), the following special rules apply:

(i) Separate determinations. The issue price of bonds in an issue that do not have the same credit and payment terms is determined separately.

(ii) Substantial amount. Ten percent is a substantial amount.

(iii) Bonds issued for property. If a bond is issued for property, the adjusted applicable Federal rate, as determined under section 1288, is used in lieu of the applicable Federal rate to determine the bond's issue price under section 1274.

Par. 4. Section 1.148-11 is amended by adding paragraph (m) to read as follows:

§1.148-11 Effective/applicability dates.

\* \* \* \* \*

(m) Definition of issue price. The definition of issue price in §1.148-1(b) and (f) applies to bonds that are sold on or after the date that is 90 days after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register.

John M. Dalrymple,

Deputy Commissioner for Services and Enforcement.

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